Attention Retirees: This Income Favourite Is at Risk of a Dividend Cut

Description

While I like a big dividend just as much as the next person, I am willing to sacrifice size for stability any day. One stock that comes to mind with a dangerously large payout is **Medical Facilities Corp** (TSX:DR), which happens to be a favorite of income-oriented investors.

Medical Facilities Corp: unsustainable payout ratio

DR operates a large portfolio of specialty and ambulatory care hospitals located throughout the United States. As such, their business model is heavily dependent on case volumes, case mix (depending on the severity of the cases) and payor mix. Payor mix is particularly important, as governmental payors such as Medicare and Medicaid pay hospitals less than private insurers.

In its most recent quarter, we saw DR report an increase in revenues of $99.1 million compared to $97.6 million in the prior year, offset by operating expenses that climbed to $88.9 million from $83.5 million, over the same period.

EBITDA margins also fell to 19.3% from 20.1%, but perhaps most troubling was its payout ratio which shot up to 166.3%, from 92.2% in 2018. While some seasonality of revenues should be expected in Q1, most of the negative performance in the first quarter could largely be attributed to a 36.4% drop in revenues at Unity Medical and Surgical Hospital (UMASH), one of DR's key locations.

Furthermore, the drop in revenues at UMASH was coupled with a large spike in operating expenses of 13.6%, resulting in negative operating margins for this location. The culprit behind the under performance? A payor mix shift that saw more weight toward government payors than private insurers.

This is particularly troubling, because if this develops into a trend, the feasibility of keeping and running UMASH comes into question.

Second, DR's Black Hills Surgical Center, which is responsible for 24% of total revenues, will be coming under competitive pressures in future quarters, thanks to a recently opened regional orthopedic surgery center located close to DR's property.

Finally, margin pressures are not restricted to UMASH. Several other centres in the portfolio also experienced major declines in year-over-year revenues and increases in operating expenses. In fact, of the nine major locations in the portfolio, operating expenses represented over 70% of revenues for eight of them.

With such low operating margins, unpredictability of payor mix, and looming competitive pressures, the market has largely begun to price in a dividend cut from DR.

I echo the sentiment of the market, and based on Q1, I see no reason why anyone should play the guessing game and wait for things to turn around, instead of avoiding this name entirely.

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